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The privatisation of public goods

The impact on governance and on the co-ordination of economic policy. A case study: cross-border leasing

1

Since neo-liberalism has become a hegemonic paradigm, public goods and public services have been privatised to an enormous extent in many countries in all regions of the world. Originally, public goods were created and established to provide people with the necessary means for human and socio-economic security on a substantial (not only formal) basis and therefore served as a fundament for social democracy. This immediately poses the question whether privatisation of public goods is beneficial or detrimental to human security (i.e. to food, water, health and environmental security as well as public security).

2

The concept of public goods, although widely used, is not as clear as it should be. It is not difficult to distinguish public goods from private goods, i.e. from commodities. The production of commodities, however, always (and necessarily) is joint production of what has been called »discommodities« (Coddington). The latter are conceptualised as social costs, i.e. *public bads*. Moreover, there are goods that have *positional* character, i.e. the material quality and hence the use value of those goods is dependent on the quantity provided and the quantity consumed. Some goods turn into »positional«, also called oligarchic or plutocratic, goods when they are provided in unlimited supply for everybody – i.e. when they are »democratised«. The quality and the use value of these goods can only be maintained when restrictions are placed on their provision and consumption.

It seems a suitable approach to define public goods with regard to the *demand side* (consumption) and *supply side* (production/provision). On the demand side (consumption), public goods are only those goods which are *non-rivalrous* and *non-exclusive*. In addition, they are expected to create positive external effects. On the supply side (production/provision), public goods are created by nature or are part of the cultural heritage. They also may be produced materially as a commonly available infrastructure, ranging from roads and railways to telecommunications and even schools and hospitals. And then there is a fourth category of public goods: the rules and institutions regulating social life or economic processes and political decision-making. These rules and institutions can be differentiated with regard to their reach or scope, from local to global. Whereas the material construction of public goods in the form of infrastructure is quite expensive under normal conditions, the provision of rules and institutions is not so costly. Naturally provided public goods and cultural heritage, on the other hand, are public goods to be protected against over-consumption and detrimental external effects (social costs, public bads).

However, the definition of public goods must also include an understanding of the *public* character of public goods. As far as decision-making regarding public goods is concerned, public deliberation is part of the democratic process. Thus the provision of public goods is a necessary element of democratic society.

3

Although the definition of public goods seems unequivocal, at second glance the concept presents several dilemmas. Some of them are well-known and have been broadly discussed in the economic (as well as ecological and sociological) literature, for instance the »tragedy of global commons« (Hardin, Ostrom): Individual rationality and public provision of commons are in conflict with a tendency to destroy the commons by following a strategy of individual maximisation of their benefits. Therefore methods of rationing public goods seem imperative to protect the commons from being transformed into positional goods. Liberals of course prefer rationing by means of privatisation of commons and the regulation of provision and consumption via the price mechanism on free markets. Social democrats and socialists, on the other hand, want some societal mechanism put in place to distribute scarce commons and the services they provide to those in need of them.

A second dilemma arises when the privatisation of public goods is used as a strategy of exclusion. In the course of this process, public goods are no longer available to the general public, but only to those who have the necessary monetary purchasing power at their disposal or for those who have some sort of entitlement. Exclusion of access to public goods can also be achieved by military power or by the power of the corporate media, e.g. the availability of public information can be restricted by monopolisation of the information itself or of the access to this information.

A third dilemma is that public »goods« for some can be public »bads« for others. One example is the public good of financial stability. It is well known in economics that open financial markets and stable exchange rates are only achievable by waiving macro-economic policy options, for instance employment policy. Financial stability, if it is at all possible in a capitalist economy, has a trade-off: unemployment.

The fourth dilemma is linked to the third. The creation of goods, public as well as private, entails negative external effects, i.e. social costs or social bads.

And lastly: public goods can change into positional goods when the provided public good is only sufficient for use by a restricted number of consumers. This case is very much related to the first case of the »tragedy of global commons«.

4

The tendency to privatise public goods has been dominant since the 1970's. First, it has become technically increasingly feasible to formally privatise public goods. Second, market strategies of trans-national corporations have discovered potential markets that previously did not exist because the product supplied was or is a public good, such as drinking water. But the potential water market triggers the greed of trans-national corporations, which then exert economic and political pressure on political institutions with the objective of privatising the provision of water. Last, the tendency toward privatisation is a political project under the auspices of globalisation. Globalisation is the flipside of de-regulation, and de-regulation means that public institutions withdraw from the provision of public goods (including rules and institutions) in order to make way for private providers and the working of the market mechanism, which is considered to be much more efficient than the public provision of public goods. Technical possibilities, market strategies combined with financial power and the political project all together reinforce strategies to privatise of public goods all over the world.

5

In a short paper it is not possible to discuss the various privatisation endeavours in different parts of the world. The technical aspects have been widely discussed in publications of the World Bank or other international institutions.

With regard to public goods we can distinguish first the *provision* of public goods by public or private suppliers and we can evaluate whether the provision of certain public goods by public institutions or private providers is better and more efficient in satisfying the needs of the public. There are many examples of an improvement in the provision of public goods by private firms (especially in the telecommunications sector in countries where people have money to spend), but there are also many examples where the privatisation of the provision of public goods had negative effects, from the British railway system to the drinking water supply in Latin-American and African cities.

Second, the *access* to public goods might be privatised: the access to roadways or to Italian inner-cities or to educational institutions. Privatisation of access is always selective and therefore excludes all those who do not have the necessary purchasing power or entitlement certificates at their disposal.

A third form of privatisation should also be mentioned: the *feminisation* of responsibilities for the provision of public goods. The withdrawal of the public sector from public services results very often in more work for women, e.g. in child-care or care-taking of the elderly. Thus privatisation of public goods does not have only a distributional effect, but a gender aspect as well.

6

The process of privatisation is linked in nearly all cases to corruption. Corrupting practices are usually endemic during the transformation of public goods into private ones. Corruption takes place mostly at the interface between public and private actors. This interface is the focus of most studies on corruption. Following this

approach, we can distinguish between petty and wholesale corruption and state involvement. Corruption may be active or passive, although this distinction is not as clear as it might seem. Many people expect a considerable decrease in corruption after the privatisation of public goods and services. But literature on »white collar crime« or »business crime« etc. raises some doubts about this benevolent assumption. Corruption also takes place at the interface between private actors and is often linked to subsequent criminal offences such as money laundering and fraudulent bankruptcy. Business criminality is a booming branch and is going on everywhere, not only in »crony capitalism« but also in such supposedly civilised countries as those that make up the G 7. The shareholder-value orientation is the economic justification for the »enrichissez vous« mindset in our times. On international markets, it does not matter which methods help maximise shareholder-value. Therefore trans-national corporations have been and are involved in illegal and even criminal activities. These activities include the (cross-border) corruption of private and very often also of political actors (e.g. as in the case of Enron).
The social costs of corruption are enormous and entail moral costs as well; overall they have negative effects on society.

A case study: cross-border leasing

Since modern capitalism has spawned innovations in the financial system, and enterprises and owners of monetary wealth have a great deal of liquidity at their disposal, the area of public goods and services is becoming a field for capital investment for private investors. They are profitably »valorised«, especially when in times of depression there are no alternatives to private investment opportunities. But how do they succeed in »valorising« when, as a rule, public goods produce no salable market values? Opera houses and public swimming pools, street cars and canal systems for sewage disposal usually have to be subsidised. Hence the transformation of unproductive into productive (i.e. producing surplus value) work that Marx mentioned does not pertain in this area.

But innovative financial markets and all the analysts and speculators, investment advisors and fund managers juggling around on them are nothing if not ingenious. First they invented financial instruments to roll up »emerging markets« of the newly industrialising countries. But after the Asian crisis business stagnated and they turned their attention to capital investments on the big stock markets, pushing the stock prices of even the most dubious companies to giddy heights during the New Economy boom they themselves had kindled and kept going well into the summer of 2000. Then the bubble of shareholder-value capitalism burst and huge amounts of capital were destroyed. But enormous sums were still free and on the lookout for new investment opportunities.

A financial innovation of global calibre is cross-border leasing (CBL), which has been scandalized in the meantime but is still being undertaken by a number of German local governments (at the beginning of 2003 there are supposed to be roughly 150) in cahoots with financial services companies and big investment funds. CBL is a sham transaction to pillage public revenue by making the investment of private capital in public goods profi-table through tax avoidance. Basically it works like this:

A local government leases the ownership of a public good (e.g. an opera house in Berlin, the sewage treatment plant in Dresden, the streetcar system in Zurich, the exhibition grounds in Essen) for 99 years to a US-American investor (head leasing) using a fiduciary trust (located in an offshore financial centre beyond the sphere of influence of the tax authorities) as a go-between. The local government then immediately leases the opera house or sewage treatment plant or whatever back (subleasiing) with the obligation to keep the facility operating in such a manner that it retains the value for the investor laid down in the leasing contract by technical experts. After 30 years the local government can exercise an option to buy the facility back, i.e. cancel the contract. If it does not exercise this option, the ownership of the facility reverts for the rest of the time stipulated in the contract (69 years) to the investor, who then can have the facility run by private investors. The leasing agreement is sweetened for the local government by the circumstance that it participates in the tax benefits that the investor claims in the USA. According to current US tax law, the leasing contract, which is valid for 99 years, is treated like a foreign investment to purchase property; it generates benefits in the form of tax write-offs on the depreciation of the purchased »property«. The reduction of taxable profits achieved in this way can be discounted from the current value of the property over a period of three decades. From this sum the local government the facility was originally leased from usually gets paid 4% to 5% immediately as »cash value«. This cash value paid onetime is what interests the keepers of the municipal treasury because it supplements their depleted household finances.

CBL is thus a means of exploiting US tax regulations for the benefit of private financial institutions in the USA with the co-operation of local European governments. The contractual construction is not without its absurdities, only they are no laughing matter. It makes the same object the property of two owners, namely that of the German municipality on this side and that of the trust or investor on the other side of the Atlantic. It is no coincidence that the business relations are extraordinarily complex and the contracts usually span several thousand pages; US-American and European financial institutions, law and engineering firms, rating agencies and, last but not least, the municipalities themselves are all involved. And they all take their cut of this privatisation deal, a sham that brings material substance and financial profit only because deregulation tax laws permit this construction for the benefit of proprietors of great wealth.

This fictitious transaction to valorise public facilities through privatisation via CBL is nothing if not a raid on public treasuries, first in the USA due to the possibilities to claim tax write-offs on allegedly purchased property. But the raid does not end there. The German municipalities as well can become victims of the raid they themselves are party to. This would be the case if the trust in the offshore centre were to lose its tax benefits in the USA, which could happen if the municipality were no longer able to keep the leased facility fully operational and if this were certified in value appraisals by the engineering firms (as stipulated in the contract). Were this to happen, the municipality would have to make good the inevitable loss of tax benefits in the USA (the »damage« incurred by the investor[1]) from tax revenue in Germany. Because in Germany the federal states and the federal government have legal liability for the municipalities, the cash value benefits the municipality gets today could turn into considerable fiscal burdens tomorrow. And if the US-American tax laws that legalise this raid on public goods by capital investors were changed, the question arises how the complicated contract could be wound up in reverse[2] and which partners in this fictitious deal would be ripped off.

In this way, local or national public facilities are turning into an area for capital investment and being integrated into the mechanisms of the global financial markets. In the case of CBL it becomes vividly clear now little global financial relations have to do with procurring capital for real investments; they have increasingly become innovative vehicles of legalised raids on public goods. The deficit-producing streetcar system in Dresden will not turn into a goldmine just because it is privatised, but rather because the CBL model makes it possible to withhold tax revenue from the public treasury by claiming tax write-offs for purchased property. Above all, the private protagonists of the CBL deal profit from this. So we end up with the paradox result that by privatising public goods – when they turn into an investment for private capital – the public means of financing public goods that stem from streams of income (i.e. from tax revenue) decline.

7

The consequences for economic policy coordination are obvious: the privatisation of public goods does not automatically improve the social and human security of people. De-regulation and privatisation reduce the capacity of state institutions to intervene in economic processes. Privatisation strategies restructure the relations between the economic, social and political spheres of society in favour of the private sector. In many cases (e.g. Argentina) the outcome is extremely negative and harmful to the people. Moreover, the privatisation of public goods usually has a regressive effect on the distribution of income and wealth stemming from access to public goods. And last but not least, the effects on gender relations are not to be taken lightly because the privatisation of certain public goods very often has a far greater impact on women than on men.

Translation: Joan Glenn

Abridged version of the paper
»What happens when public goods are privatised?«
(www.wem-gehoert-die-welt.de)

1 Conversely, this »damage« incurred by the investor would be an additional source of tax revenue for the government of the USA, which would have to be paid by the German municipality. In this deal only the »investor« cannot lose.
2 The contracts are drawn up in accordance with US-American law (the jurisdiction is always New York). Usually only an abridged version is shown to the responsible people in the municipality. There is every reason to fear that in the case of legal disputes the municipalities will have a hard time asserting their position against the trust, law firms and investors in the jurisdiction of New York. That is why critics emphasise that CBL is high-risk venture.